

Internal Revenue Service

Number: **200725008**

Release Date: 6/22/2007

Index Number: 2601.00-00, 2501.00-00,
1001.00-00, 1223.00-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:4

PLR-110138-06

Date: Mach 13, 2007

In Re:

Legend:

Trust =

Trustee =

Settlor =

Spouse =

X =

Y =

Z =

G =

J =

K =

L =

R =

S =

T =

U =

Date 1 =

Date 2 =

State Statute =

Court =

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Dear :

This is in response to your authorized representative's submission dated August 16, 2006, and prior correspondence, in which rulings were requested on the income, gift and generation-skipping transfer (GST) tax consequences of a proposed division of a trust.

According to the facts submitted, on Date 1, Settlor created Trust, an irrevocable trust, for the benefit of Spouse and their children, X, Y, and Z. Date 1 is prior to September 25, 1985. Spouse died on Date 2.

Trust provides that upon Spouse's death, the Trustee shall divide the then remaining principal and undistributed income into as many equal shares as there are children of Settlor then living or deceased with issue then living. Trustee shall allocate one such equal share to each such child then living and one such share to the living issue of each such child then deceased and shall hold the same in a separate trust. Accordingly, pursuant to the terms of Trust, Trust was divided into three separate trusts, Trust X, Trust Y, and Trust Z, one trust for each living child of Settlor and such child's family. This ruling pertains to Trust Z. G is Z's spouse and they have three children, J, K and L.

Trust provides that the Trustee of Trust Z may pay to or for the benefit of any one or more of Z, Z's spouse, and Z's issue, so much of the net income or principal of Trust Z as the Trustee in its uncontrolled discretion may determine. Any net income not distributed within 90 days after the close of the fiscal year is added to principal.

Trust provides that Trust Z shall continue during the lifetime of Z and Z's issue living on Date 1. Upon termination of Trust Z, the Trustee will distribute the principal and accumulated income to the issue of Z, per stirpes. Trust provides that, anything to the contrary notwithstanding, any such trust created under Trust will terminate if it has not previously terminated twenty-one years after the death of the last survivor of the following persons living at the date Trust was executed: Spouse, X, Y, Z, J, K, L, R, S, T, and U.

Trust provides that if Trust Z at any time fails for want of a beneficiary, the remaining principal and undistributed income of Trust Z is to be reapportioned in equal parts among other trusts created under Trust, including any such trust theretofore distributed, and one such equal part is to be added to the undistributed trust to which it is so reapportioned and thereafter is to follow the fortunes thereof and one such equal part so reapportioned to a theretofore distributed trust is to be paid over by Trustee to the person or persons who would be entitled to the assets of such theretofore distributed trust had the same become distributable.

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It is represented that, at the present time, J, K, and L, and their respective issue are geographically spread out and that the division of Trust Z into three shares would permit easier and more efficient administration of the trust estate. Accordingly, Z, G, J, K, and L, propose to divide Trust Z into three separate trusts of equal value on a pro rata basis, one trust to benefit each child (Child) J, K, and L, and each Child's respective issue. Trust J would be held and administered for the benefit of Z, G, J, and J's issue. Trust K would be held and administered for the benefit of Z, G, K, and K's issue. Trust L would be held and administered for the benefit of Z, G, L, and L's issue. The terms of Trust J, Trust K, and Trust L would be substantially identical to the terms of Trust and Trust Z, except that the income provision would be modified to provide that each Trustee may pay to or for the benefit of Z, G, Child (J, K, or L) and Child's issue. The division of Trust Z would be pursuant to an order by Court.

The following rulings are requested:

1. The proposed division of Trust Z into Trust J, Trust K, and Trust L will not cause any of the trusts to be subject to the provisions of chapter 13 and will not constitute an addition to the trusts for purposes of chapter 13.
2. The proposed division of Trust Z will not cause any beneficiary of Trust Z, Trust J, Trust K, or Trust L to be considered as having made a taxable gift and will not constitute a taxable gift to those beneficiaries under § 2501.
3. Neither the division of Trust Z nor the distributions of the assets to Trust J, Trust K, and Trust L on a pro rata basis will result in the recognition of gain or loss for federal income tax purposes.
4. The assets distributed from Trust Z to Trust J, Trust K, and Trust L on a pro rata basis will retain the same tax basis under § 1015 as the assets had in Trust Z before the division.
5. The assets distributed from Trust Z to Trust J, Trust K, and Trust L on a pro rata basis will retain the same holding period under § 1223(2) as the assets had in Trust before the division.

State Statute provides that an irrevocable trust may be modified by the court with the consent of all of the beneficiaries if continuance of the trust on the same or different terms is not necessary to carry out a material purpose and the consent of a person who may bind a beneficiary is considered the consent of the beneficiary.

Ruling 1.

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Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer. Section 2611(a) defines a generation-skipping transfer as a taxable distribution, a taxable termination or a direct skip.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, § 26.2601-1(b)(1)(i) provides that the GST tax does not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. The exception of § 26.2601-1(b)(1)(i) does not apply to a pro rata portion of any generation-skipping transfer under an irrevocable trust if additions are made to the trust after September 25, 1985. Section 26.2601-1(b)(1)(ii)(A) provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) or (C), any trust (as defined in § 2652(b)) in existence on September 25, 1985, is considered an irrevocable trust.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. The rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(E), Example 5, illustrates a situation where a trust that is otherwise exempt from GST tax is divided into two trusts. Under the facts of the example, the division of the trusts into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person who held the beneficial interest prior to the division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the two partitioned trusts resulting from the division of the trust will not be subject to the provisions of chapter 13.

Trust was irrevocable on September 25, 1985, and it is represented that no additions, constructive or otherwise, have been made to Trust since September 25, 1985. Trust Z was established pursuant to the terms of Trust and, accordingly, is exempt from GST tax. Trust J, Trust K, and Trust L will have substantially the same terms as Trust and Trust Z. The proposed division of Trust Z into Trust J, Trust K, and Trust L will not result in a shift of any beneficial interest in Trust Z, Trust J, Trust K, or Trust L to any beneficiary who occupies a generation lower than the persons holding the beneficial interest prior to the division. The proposed division will not extend the time for

vesting of any beneficial interest in Trust Z, Trust J, Trust K, or Trust L beyond the period provided for in the original trust. Accordingly, we conclude that the division of Trust Z into Trust J, Trust K, and Trust L will not cause Trust Z, Trust J, Trust K, or Trust L to be subject to the provisions of chapter 13 and will not constitute an addition to Trust Z, Trust J, Trust K, and Trust L for purposes of chapter 13.

Ruling 2.

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual. Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 25.2511-1(c)(1) of the Gift Tax Regulations provides that any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

The division of Trust Z into Trust J, Trust K, and Trust L is consistent with applicable State law. Following the division of Trust Z, the beneficiaries of Trust J, Trust K, and Trust L will have the same beneficial interests in those trusts as they had in Trust Z. Therefore, based on the facts submitted and representations made, we conclude that the division of Trust Z into Trust J, Trust K, and Trust L will not cause any beneficiary of Trust Z, Trust J, Trust K, or Trust L to be considered as having made a taxable gift and will not constitute a taxable gift to those beneficiaries under § 2501.

Ruling 3.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1.1001-1(a) of the Income Tax Regulations provides that except as otherwise provided in subtitle A of the Code, the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

For purposes of § 1001, in an exchange of property, each party to the exchange gives up a property interest in return for a new or additional property interest. Such an exchange of property is a disposition under § 1001(a). See § 1.1001-1.

An exchange of property results in the realization of gain under § 1001 if properties exchanged are materially different. Cottage Savings Ass'n v. Comm., 499

U.S. 554 (1991). A material difference exists when the exchanged properties embody legal entitlements "different in kind or extent" or if they confer "different rights and powers." Id. at 565. In Cottage Savings, the Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. Id. at 566. In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that is "material" to the Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Id. at 564-65.

The proposed division of Trust Z into Trust J, Trust K, and Trust L will not cause Trust Z or the successor trusts to differ materially. The division of Trust Z into Trust J, Trust K, and Trust L with substantially identical terms and provisions will not be considered a sale, exchange, or other disposition of property differing materially in either kind or extent.

Accordingly, the division of Trust Z into Trust J, Trust K, and Trust L will not be treated as a sale or other disposition of property, and does not result in a material difference in the legal entitlements enjoyed by the beneficiaries under Cottage Savings. Accordingly, no gain or loss is recognized on the partition of the trust for purposes of § 1001(a). We conclude that the proposed division of the original trust will not constitute a taxable disposition under § 1001.

Rulings 4 & 5.

Section 1015 provides that the basis in property acquired by a transfer in trust is the same as it would be in the hands of the grantor, with adjustments for gain and loss recognized.

Section 1015(b) provides that if property is acquired by a transfer in trust (other than a transfer by gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on such transfer.

Section 1.1015-2(a)(1) of the Income Tax Regulations provides that in the case of property acquired after December 31, 1920, by a transfer in trust (other than by transfer in trust by gift, bequest or devise), the basis of property so acquired is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by transfer in trust, this basis applies whether the property be in the hands of the trustee, or the beneficiary, and whether acquired prior to termination of the trust and distribution of the property, or thereafter.

Section 1223(2) provides that in determining the period for which a taxpayer has held property, however acquired, there is included the period for which the property was held by any other person, if under Chapter 1 of Subtitle A of the Code, the property has, for the purposes of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as it would have in the hands of the other person. See also § 1.1223-1(b) of the Income Tax Regulations.

In the instant case, the division of Trust Z into Trust J, Trust K, and Trust L of equal value on a pro rata basis is a non-taxable event under § 1001. Because § 1001 does not apply, pursuant to § 1015, the basis of the successor trusts' assets will be the same after the partition as the basis of the assets before the partition. Furthermore, pursuant to § 1223(2), the holding period of the assets in the hands of Trust J, Trust K, and Trust L will include the holding period of the assets in the hands of Trust Z.

The rulings contained in this letter are based upon information and representations submitted by the taxpayers and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

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